report

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REPORT OF THE CHIEF FIRE OFFICER

PARTICIPATION IN THE FIRE AND RESCUE SERVICES MUTUAL INSURANCE COMPANY

1. PURPOSE OF REPORT

To advise Members of the research and development work that has been undertaken to date regarding alternatives to the purchasing of traditional insurance cover. The report also identifies options, opportunities and risks for Nottinghamshire Fire and Rescue Service in its continued participation in the Fire Services Mutual Insurance Company and requests authorisation for the relevant officer to pursue the most appropriate course of action.

2. BACKGROUND

2.1 Early in 2006, five English Fire and Rescue Authorities (FRAs) began to investigate the benefits and options of an alternative to traditional insurance as a method of financing risk. The motivations for the initial investigations were centred on the high cost, or unavailability of certain types of insurance cover.

2.2 Following these initial investigations, Firebuy were notified of the results, along with the suggestion that alternative risk financing may offer benefits across all English FRAs. As a result of this, Firebuy took the opportunity to assume the co-ordination and management of a project to further investigate the feasibility of establishing a vehicle to provide an alternative risk transfer mechanism. Public Risk Management (PRM) were engaged as consultants to deliver the next stage of the project.

2.3 At this point, an invitation was made to the remaining English FRAs to participate in a data collection exercise to establish the potential benefits of an alternative risk transfer vehicle on a larger scale. An additional eleven FRAs joined this exercise, including Nottinghamshire. The results of this exercise led to suggestions by PRM that all FRAs that participated in the data collection exercise could expect significant financial savings by establishing an alternative risk transfer vehicle to provide the insurance covers currently purchased from the traditional insurance market.

2.4 All participants agreed that the project should move forward to the next stage which was to undertake a feasibility study to establish the most appropriate type of alternative risk transfer vehicle, and the production of business models and financial projections. The consultants selected to undertake the feasibility study, Charles Taylor Consulting (CTC), have a wealth of experience in the development of alternative risk transfer vehicles and are one of the few companies in the country to provide such a service.

3. REPORT

3.1 CTC have recommended a UK-based mutual as the most appropriate alternative risk transfer vehicle for English FRAs. Firebuy has sought legal opinion from Queens Counsel on the ability of FRAs to form a mutual and has received a positive response. However, Firebuy still intend to approach the relevant Secretary of State with a request for the granting of a specific authorisation under s.29 of the Fire and Rescue Services Act 2004.

3.2 Modeling for the mutual has been based on each of the FRAs placing their insurance covers with the mutual on the expiry of their current Long Term Agreements. For Nottinghamshire, this would result in the placement of risk with the mutual from 1st April 2011.

3.3 As the business model for the mutual is based on the participation of all FRAs currently involved in the project the failure of a FRA to enter the mutual as planned would affect the feasibility of the mutual to the extent that it may cease to be a viable option. Recent correspondence from Firebuy shows that 7 FRAs have already committed fully to the mutual and therefore this viability is assured.

3.4 Savings against projected insurance premiums in 2011 are quoted by CTC as being 15% (£70,000 at 2007 prices), although this does not take account of the effect that the mutual may have on pricing strategy in the insurance market. Faced with competition, insurers may elect to underwrite the risks at a discounted rate in order to retain the business. At the present time, it is unclear how the market will react and thus validate the potential savings the mutual will deliver.

3.5 It is important to note however that if commercial insurers heavily discount premiums to frustrate the Mutual Company this can not be in the long term interests of the Service.

3.6 In addition to the premiums to be paid to the mutual, participating FRAs are required at the outset to capitalise the vehicle through a one-off cash contribution (£9,000) and the provision of a guarantee (£98,500), these figures being based on the claims history and premium payments of the FRA.

3.7 However, once a FRA places its risk with the mutual, its potential financial liabilities increase. Should the mutual be subjected to claims over and above the worst-case scenario envisaged in the business model, members will be required to provide funding over and above their initial cash contribution and guarantee, amounting initially to a maximum of 50% of the annual premium payment (£198,000 for 2011/12). If necessary, the mutual can then seek to request further financial backing from the members having placed risk, through a resolution at an annual or extraordinary general meeting.

3.8 In order to mitigate this risk the Mutual will take out reinsurance cover and has already promised prudent underwriting. It has been established that the reinsurance that is being sought by the Mutual Company has no limit of indemnity and is also underwritten “sideways” to ensure that stop losses and aggregates are also reinsured. This should mean that the risk of members having to contribute additional finance over and above the initial capitalisation and annual premium payments should be exceptionally low. The remaining risk is that of a reinsurer failing which of course is potentially damaging but no more so than the existing risk of a primary insurer failing.

3.9 Nevertheless the provisions of the Financial Services Act insist that the Mutual Company should show that it has the necessary reserves or guarantees to meet any such liabilities. However, this risk still exists, particularly during the formative years of the mutual where its assets will be limited

3.10 CTC predict that contributing FRAs will benefit from the return of their initial investment in the mutual, plus a share of any surplus accumulated, after the mutual has been operational for five years. The return of this investment and surplus is likely to be through premium reductions. However, any poor claims performance will delay this return.

3.11 The mutual will offer the same range of insurance currently purchased by all FRAs. Most of these will be provided directly by the mutual, but other, more specialised covers, such as marine hull will be purchased by the mutual on behalf of the FRAs wanting that cover. It is currently uncertain whether the mutual will provide aggregate stop-loss protection, and this may result in an extra cost that will further erode the financial benefits of participation.

3.12 The strategic management of the mutual will be the responsibility of a board of directors. The exact composition of the board is yet to be finalised, but will reflect Financial Services Authority regulations, which require that a minimum of two independent directors with insurance industry experience be appointed. The remaining seats on the board will be for representatives of the members of the mutual.

3.13 In the early stages it has been decided that the Directors will be the Directors of Finance of the original 7 Members but this could be extended or changed later. It is considered important that Nottinghamshire is adequately represented on the board, to ensure that the mutual does not develop in a way that is beneficial only to larger FRAs. Firebuy recommend that directors are of director level in the member organisations and it is therefore recommended that the Head of Finance and Resources is nominated for election to the board when this option becomes available.

3.14 The day-to-day management of the mutual will be undertaken by a professional organisation, to be determined by the board. Given that there are few companies providing this service it is likely that CTC will be awarded the contract, particularly given their knowledge of the project to date.

3.15 FRAs will be responsible for making their own arrangements for claims handling where the value of the claim is 75% or less of the deductible (i.e. £7,500 for Employers Liability). This will impose an additional cost to Nottinghamshire in terms of retaining professional claims handlers, or in providing resources for an internal claims handling function. Claims of 75% or more of the deductible will be handled by the mutual, which will appoint its own claims handlers. There are benefits where the mutual handles claims as data can be shared in order to benchmark, develop risk control measures and detect/control fraud.

3.16 FRAs will not have to commit to a long term agreement with the mutual and it is further proposed that a FRA can exit the mutual at any time, providing a minimum of six-months notice is given to the board. On exit from the mutual, the FRA will continue to attract liabilities in terms of the finance of claims falling in the years during which it was a member, although there may be an opportunity for the FRA to buy its way out of these liabilities.

4. RISK MANAGEMENT IMPLICATIONS

4.1 Nottinghamshire Fire and Rescue Service will not be expected to place risk with the mutual until the expiry of the LTAs on all its current covers in 2011. This eliminates the risk that the failure of the mutual in the early years of its formation will impact on the continuity of insurance cover.

4.2 By providing capitalisation to the mutual, the financial risk to the Service is the combined total of the cash contribution and guarantee. This risk is offset to a certain extent by reducing the risk of increased capitalisation requirements that may be imposed on later entrants to the mutual. By providing the initial capitalisation, the risk of the mutual failing is reduced.

4.3 That Firebuy are seeking specific authorisation from the Secretary of State for this venture would suggest that they are not fully comfortable with the opinion provided by Queens Counsel. There is, therefore, a risk that the mutual may not be formed as intended. As Nottinghamshire Fire and Rescue Service is not reliant on the mutual for providing insurance cover in the short-term, the risk of the mutual not being formed is acceptable.

4.4 There is a risk that Nottinghamshire Fire and Rescue Service will incur additional costs on entering the mutual due to the requirement to provide a claims handling facility for claims within 75% of the deductible and the possibility that aggregate stop loss insurance will need to be purchased separately. These costs are unlikely to exceed the savings that may be generated by the Mutual.

4.5 The strategic management of the mutual will present a potential risk if Nottinghamshire Fire and Rescue Service are not adequately represented on the board. Should the board be comprised wholly of larger FRAs, there is the possibility that the conditions of entry and membership may favour larger FRAs over smaller ones. The first board will contain representatives from a number of CFAs and so therefore this risk is diminished.

4.6 While the flexible exit arrangements proposed reduce risk for individual FRAs, this will increase the risk of the mutual failing, or requiring additional finance from remaining members.

4.7 Overall, there are both downside and upside risks (threats and opportunities) arising from this proposal. Nottinghamshire Fire and Rescue Service would appear to be in a strong position to contribute to the success of the mutual through the initial capitalisation. The risk to the continuity of insurance cover can be minimised by keeping a ‘watching brief’ on the performance of mutual in the lead up to the placement of risk in 2011.

5. FINANCIAL IMPLICATIONS

5.1 As the Authority will not be placing risk with the Mutual until 2011 there will be no premiums to be paid until that date. All insurance will carry on as at present.

5.2 The Capital contribution to the mutual does not affect the revenue account as this is treated as an investment.

5.3 The Guarantee to the mutual of £100,000 does not need to be included within the accounts other than as a note as a “contingent liability”. It will however be included as part of the risk assessment process for the determination of balances and reserves.

5.4 Entering into the Mutual Company at this time is considered a low risk option financially. This is because no additional calls can be made on the Authority until such time as risk is placed with the Mutual.

6. PERSONNEL IMPLICATIONS

6.1 There are no specific personnel implications arising from this report.

7. EQUALITY IMPACT ASSESSMENT

Whilst a full Equality Impact Assessment has not been carried out it is considered that there will be no implications or impacts on equalities.

8. RECOMMENDATIONS

It is recommended that :-

8.1 Members note the potential benefits to be gained from participating in the mutual.

8.2 The Head of Finance and Resources be given authority to join, withdraw, or participate as appropriate in the mutual, at the most appropriate time, having given regard to the available facts and professional advice.

8.3 When appropriate, members endorse the nomination of the Head of Finance and Resources as a candidate for membership of the board of the mutual.

9. BACKGROUND PAPERS FOR INSPECTION

- Letter from FireBuy dated 9/11/2006 setting out questions and answers regarding the mutual.

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